

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION,)	
)	
)	
Plaintiff,)	
v.)	1:11-CV-02239-RLW
)	
GRACO INC.,)	PUBLIC VERSION
)	
ILLINOIS TOOL WORKS INC., and)	
)	
ITW FINISHING LLC,)	
)	
Defendants.)	

**PLAINTIFF FEDERAL TRADE COMMISSION'S
MEMORANDUM IN SUPPORT OF MOTION FOR TEMPORARY
RESTRAINING ORDER AND PRELIMINARY INJUNCTION**

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**PLAINTIFF FEDERAL TRADE COMMISSION’S
MEMORANDUM IN SUPPORT OF ITS MOTION FOR A TEMPORARY
RESTRAINING ORDER AND PRELIMINARY INJUNCTION**

Pursuant to 13(b) of the Federal Trade Commission Act (“FTC Act”), 15 U.S.C. § 53(b) (2007), Plaintiff Federal Trade Commission (“FTC” or “Commission”) petitions the Court to enjoin Graco Inc. (“Graco”) from acquiring the interests and assets of ITW Finishing LLC (“ITW”) from Illinois Tool Works, pending a full Commission hearing on the competitive merits of the acquisition under Sections 7 and 11 of the Clayton Act, 15 U.S.C. §§ 18, 21 (2008), and Section 5 of the FTC Act, 15 U.S.C. § 45 (2007). Without relief from this Court, Graco may acquire ITW any time after December 17, 2011.

INTRODUCTION

Graco’s acquisition of its largest close competitor, ITW, threatens to combine the two largest manufacturers of industrial liquid finishing equipment sold in North America into an industry giant. Other manufacturers are far smaller in scale and suffer from poorer access to and support from independent distributors a necessary ingredient of successful competition in this

industry. [REDACTED]

[REDACTED] Graco's dominance will hurt its customers and North American industrial end users through reduced discounts and innovation. The FTC has initiated administrative litigation on the merits of this case, and trial will begin on May 15, 2012. The sole issue before this Court is whether to preserve the status quo pending the administrative trial.

A preliminary injunction clearly is in the public interest under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b) (2007). In addition to the strong public interest in the effective enforcement of the nation's antitrust laws, *see FTC v. Whole Foods Mkt., Inc.*, 548 F.3d 1028, 1035 (D.C. Cir. 2008) (Brown, J.) (citing *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 726 (D.C. Cir. 2001)); *FTC v. Food Town Stores, Inc.*, 539 F.2d 1339, 1343 (4th Cir. 1976) ("The equities to be weighed are not . . . the usual equities in private litigation. . . ."), the evidence raises "questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." *Heinz*, 246 F.3d at 714-15 (quoting *FTC v. Beatrice Foods Co.*, 587 F.2d 1225, 1229 (D.C. Cir. 1978)).

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]¹ Graco and ITW [REDACTED] compete

¹ [REDACTED]

closely and aggressively against each other on price and product offerings. Graco and ITW more frequently win business from each other than from anyone else. They give discounts to distributors for carrying and promoting their products, and they grant additional price breaks to beat each other's prices. Both firms hold distinct advantages over their rivals, including broader product lines, wider brand acceptance, larger installed bases of end users, and a ubiquitous, mostly shared distributor network capable of reaching virtually every industrial end user in North America. [REDACTED]

[REDACTED]²

Graco and ITW together dominate the sale of industrial liquid finishing equipment in North America. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] Other fringe players sell far less in North America and cannot keep Graco in check post-acquisition, due to their relatively weaker distribution and niche products designed for specific end uses. As measured by the Herfindahl-Hirschman Index ("HHI"), the acquisition significantly increases concentration in an already highly-concentrated industry, resulting in a post-acquisition HHI of over 4400 and an increase in HHI of approximately 2000. The

[REDACTED]

[REDACTED]²

[REDACTED]³

thresholds embraced in case law and in the U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines (rev. 2010) (“Merger Guidelines”) demonstrate that Graco’s acquisition is presumptively anticompetitive. Defendants’ ordinary-course business documents, witness testimony, and evidence of these firms’ competitive sales efforts confirm what should already be apparent – the acquisition will likely hurt competition and North American industrial end users by eliminating Graco’s largest close rival and further consolidating an already highly-concentrated industry.

The same story is true regarding specific types of industrial liquid finishing equipment pumps, spray guns, and plural component equipment (proportioners), which constitute the main categories of products in this industry. Graco and ITW compete closely in pumps, spray guns, and proportioners. The acquisition increases market concentration for each product type, to a degree ranging from [REDACTED] (or more) to essentially a merger-to-monopoly in circulation pumps used in automotive assembly plants. While Graco’s and ITW’s sales and shares within each product type differ somewhat, competition is fundamentally the same for each product and across them all, in terms of the importance of product reliability, strong brand reputation, and a loyal installed base of end users tied to local, high-quality distribution.

If past is prologue, new entry or repositioning by current firms will not deter Graco from dominating the industry post-acquisition. Graco and ITW have long enjoyed extraordinarily high market shares and margins, [REDACTED]

[REDACTED] Exel and smaller firms lack the requisite strong

4 [REDACTED]

distribution to deter post-acquisition competitive injury.⁵ The inability of firms to enter and gain traction in the industry, despite stable and attractive margins, demonstrates that high barriers make entry or repositioning unlikely, even if Graco raises prices post-acquisition. This explains why numerous Graco and ITW distributors will not stand up to Graco post-acquisition. These distributors see no option but to accept any post-merger Graco price increase and pass it on to their customers.

Defendants have not shown how the acquisition will create substantial cognizable benefits to counter the weighty presumption in favor of injunctive relief. *See Whole Foods*, 548 F.3d at 1035 (Brown, J.) (citing *Heinz*, 246 F.3d at 727; *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 903 (7th Cir. 1989)). To the contrary, Graco plans to operate the businesses separately post-acquisition. [REDACTED]

[REDACTED] Because these synergies are also speculative and likely could be achieved even without this acquisition, no equities overcome the presumption in favor of injunctive relief. *See FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 76-77 (D.D.C. 2009) (“The uncertainty of the public benefit of innovative products is too long in coming and too uncertain in result to hold much weight against the FTC’s interest in enforcing the antitrust laws.”).

⁵ [REDACTED]

STATEMENT OF FACTS

I. Industrial Liquid Finishing Equipment

Industrial end users purchase liquid finishing equipment to spray a finish or coating on all kinds of consumer and industrial goods, everything from automobiles and home appliances to wood cabinets and golf clubs. Almost every surface requires a finish, for aesthetic value, surface protection, or other purposes. The traits provided by the finish are often the reasons why a customer chooses one finished product over another.

From the equipment end user’s standpoint, a range of problems can arise if finishing equipment does not work well. A poor paint job harms the appearance and performance of a manufactured good, risking loss of sales and reputational harm to the seller far beyond the cost of finishing the product.⁶ Poor finishing equipment may lead to higher operating costs, in terms of energy use, wasted paint, and maintenance expenses.⁷ In continuous process manufacturing, the complete or partial failure of finishing equipment could even force production to shut down.⁸ Industrial end users thus look for reliable, proven finishing equipment and demand local service that is available whenever a problem arises, day or night.

Industrial liquid finishing equipment differs from other types of equipment and from finishing equipment sold to other types of customers. Powder coating systems, for example, involve the spraying of a dry-mix material to a surface, which is then cured by applying heat. Typically, powder coating systems and liquid finishing systems do not compete. Powder coating

⁶ [REDACTED]

⁷ [REDACTED]

⁸ [REDACTED]

requires different equipment, is suitable for different end use applications, yields different quality finishes, and is sold through its own distribution channel.⁹

Moreover, liquid finishing equipment for industrial use generally differs from spray equipment sold to contractors and retail consumers. Industrial users require durable and reliable finishing equipment capable of repeated or continuous use in a factory environment.¹⁰ Industrial users evaluate the efficiency of their finishing equipment in terms of energy costs and wasted paint. Few contractors and retail consumers want, or would be willing to pay for, the high performance needed in industrial equipment, and separate channels and products exist for retail and contractor sales.¹¹

Industrial liquid finishing equipment includes specialized pumps to move the liquid and specialized spray guns to apply the liquid to the surface to be finished. In some systems, plural component equipment (proportioners) blend paint with catalysts or other liquids before application. Other parts and accessories including tanks, conveyor belts, filters, booths, ovens, and tubing tie the components together into a complete paint system. Depending on the needs of the end user, industrial liquid finishing equipment can be integrated into an engineered paint system or sold as individual equipment components. As durable goods, the sale of industrial liquid finishing components or systems leads to significant future business for parts and service.

9

10

11

II. The Importance of Distribution: [REDACTED]

Industrial liquid finishing equipment manufacturers rely on independent distributors to provide the local sales, service, support, and training required by finishing equipment end users. Distribution is critical to industrial liquid finishing equipment manufacturers and distinguishes one manufacturer from another. [REDACTED]

[REDACTED]²

Industrial liquid finishing equipment manufacturers sell the overwhelming majority of their equipment to distributors, who resell to industrial end users.¹³ Although some industrial liquid finishing equipment manufacturers occasionally sell directly to end users, these tend to be sales of engineered systems rather than the standard out-of-the-box components that constitute the overwhelming majority of sales in this market.¹⁴ No large manufacturer of industrial liquid finishing equipment uses direct sales as its primary or preferred method of distribution,¹⁵ and Graco itself makes no sales directly to end users. Because distributors provide local sales and support, equipment manufacturers do not need the internal resources to support their equipment in each of the thousands of industrial end users' facilities.¹⁶ By carrying other types of equipment and products, distributors can provide "one-stop shopping" to end users.¹⁷

12 [REDACTED]

13 [REDACTED]

14 [REDACTED]

15 [REDACTED]

16 [REDACTED]

17 [REDACTED]

End users look to distributors to provide an entire liquid finishing solution a bundle of goods and services to meet their finishing needs. [REDACTED]

[REDACTED]⁸ Distributors are, in effect, value-added resellers. Beyond simply selling components, distributors also offer a “total value proposition” to end users, which includes [REDACTED]

[REDACTED]¹⁹

After a distributor sells equipment to an end user, the distributor can expect additional business for spare and replacement parts and accessories. Selling and servicing the installed base of end users is often a major portion of a distributor’s business.²⁰ [REDACTED]

[REDACTED]

[REDACTED]²¹

Distributors must be finishing specialists. Sellers of other industrial products often lack the specialized product knowledge and technical expertise that industrial liquid finishing end users require.²² [REDACTED]

[REDACTED]

18 [REDACTED]

19 [REDACTED]

20 [REDACTED]

21 [REDACTED]

22 [REDACTED]

[REDACTED]

All industrial liquid finishing equipment distributors are not the same. They vary widely in size, number of employees, technical sophistication and specialization, geographic reach, and financial wherewithal to sell and support industrial liquid finishing manufacturers' products.²⁵

[REDACTED]

[REDACTED]²⁶ Ultimately, the pool of strong, quality distributors is limited.²⁷ [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]²⁸

23 [REDACTED]

24 [REDACTED]

25 [REDACTED]

26 [REDACTED]

27 [REDACTED]

28 [REDACTED]

[REDACTED]

[REDACTED]

III. Graco and ITW Compete Closely and Fiercely Today

Vigorous competition exists today between the two largest industrial liquid finishing equipment manufacturers, Graco and ITW. [REDACTED]

[REDACTED]

[REDACTED]³³ If faced with a post-merger price increase by Graco, these distributors would not stand up to Graco and would have no alternative but to try to raise their own prices.

29 [REDACTED]

30 [REDACTED]

31 [REDACTED]

32 [REDACTED]

33 [REDACTED]

and ITW also offer special promotions, which give distributors additional rewards for selling particular products.³⁸

Graco and ITW compete directly against each other by offering special one-time discounts to their distributors to help win end-user business, whether for pumps, spray guns, or proportioners.³⁹

[REDACTED]

Graco and ITW develop and improve new pumps, new spray guns, and new proportioners, often to match offerings of the other firm.

[REDACTED]

³⁸ [REDACTED]

³⁹ [REDACTED]

⁴⁰ [REDACTED]

⁴¹ [REDACTED]

⁴² [REDACTED]

[REDACTED]⁴³ Pump competition provides

but one example, [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]⁴⁵

Even more telling evidence of close competition between Graco and ITW comes from both firms' attempts to win competitive sales. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

43 [REDACTED]

44 [REDACTED]

45 [REDACTED]

46 [REDACTED]

47 [REDACTED]

[REDACTED]

[REDACTED]

After the acquisition, Graco's customers would have no effective recourse to curb the loss of this competition. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] 0

Graco knows its marketplace. [REDACTED]

[REDACTED] For distributors, access to Graco's and ITW's products and participation in their discount programs create strong incentives for distributors to push Graco or ITW products and enhance distributors' reluctance to

48 [REDACTED]

[REDACTED]

49 [REDACTED]

50 [REDACTED]

51 [REDACTED]

[REDACTED]

carry or promote other equipment brands. Because few distributors would jeopardize their relationship with Graco (and their sales to the Graco installed base) by promoting other brands, distributors would have no effective defense to higher prices or lower discounts from Graco post-acquisition. Furthermore, because Graco and ITW both tie their discount levels to the distributors' commitments to carry certain inventory levels, purchase demonstration equipment, and participate in product training, distributors could lose these investments if they lost access to Graco and ITW products.⁵² [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]⁵³

In fact, Graco already wields tremendous influence over the competing brands its distributors carry *today*. [REDACTED]

[REDACTED]

[REDACTED]⁵⁵ In some product categories, Graco requires its distributors to promote Graco products ahead of other brands in order to earn its maximum discounts.⁵⁶ [REDACTED]

[REDACTED]

⁵² [REDACTED]

⁵³ [REDACTED]

⁵⁴ [REDACTED]

⁵⁵ [REDACTED]

⁵⁶ [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]⁵⁷ [REDACTED]⁵⁹ Fear of Graco's reaction in terms of jeopardizing access to Graco products and maintaining discounts significantly discourages distributors from switching to rival brands.⁶⁰

Taken together, the overwhelming evidence tells a consistent and compelling story. By this acquisition, Graco will free itself of marketplace pressure from its largest competitor, ITW. Distributors of pumps, spray guns, and proportioners and their industrial customers will have little choice but to accept higher prices and reduced innovation.

IV. The Proposed Acquisition

In April 2011, the parties announced Graco's proposed \$650 million acquisition of ITW [REDACTED]

⁵⁷ [REDACTED]

⁵⁸ [REDACTED]

⁵⁹ [REDACTED]

⁶⁰ [REDACTED]

[REDACTED]

After an investigation, the Commission found reason to believe that the acquisition would violate the Clayton and FTC Acts and, on December 15, 2011, the Commission voted to initiate an adjudicative proceeding to determine the legality of the acquisition. The Commission also authorized FTC staff to file a complaint in this Court under Section 13(b) of the FTC Act, seeking a temporary restraining order and a preliminary injunction to preserve the status quo pending a full hearing on the merits in the administrative proceeding. Unless this Court grants the Commission’s motion, Defendants will consummate the proposed transaction before the resolution of the Commission’s administrative trial. This will make it difficult, if not impossible, to reestablish completely the competitive *status quo ante*, should the Commission find the acquisition unlawful.

ARGUMENT

Section 13(b) of the FTC Act provides that the Court may grant the FTC’s motion for a preliminary injunction if, upon “weighing the equities and considering the Commission’s likelihood of ultimate success, such action would be in the public interest.” 15 U.S.C. § 53(b); *see also Food Town Stores*, 539 F.2d at 1344 (Section 13(b) prescribes as standards for injunctive relief “(1) the likelihood of success, and (2) a balancing of public equities.”). The

61 [REDACTED]

62 [REDACTED]

“only purpose of a proceeding under [Section 13(b)] is to preserve the status quo until FTC can perform its function.” *Food Town Stores*, 539 F.2d at 1342; accord *Whole Foods*, 548 F.3d at 1035 (Brown, J.), 1050 (Tatel, J., concurring).

The FTC Act codifies a public interest standard meant to make injunctive relief more readily available for the FTC “an expert agency acting on the public’s behalf” than for private litigants. *Whole Foods*, 548 F.3d at 1042 (Tatel, J., concurring); *CCC Holdings*, 605 F. Supp. 2d at 36 n.11 (“[P]recedents irrefutably teach that in this [Section 13(b)] context ‘likelihood of success on the merits’ has a less substantial meaning than in other preliminary injunction cases. *Heinz* not only emphasized this point but *Whole Foods* makes it clear that *Heinz* remains good law.”). The “traditional equity standard which the common law applies to private litigants” does not apply to FTC actions under Section 13(b). *Food Town Stores*, 539 F.2d at 1343.

The Court must balance the FTC’s likelihood of success and the equities on a sliding scale as an acquisition’s demonstrated risk to competition increases, Defendants must present stronger evidence of “particularly strong equities” that favor allowing their acquisition to be consummated immediately. See *Whole Foods*, 548 F.3d at 1041 (Brown, J.) (the “FTC need only show a likelihood of success sufficient, using the sliding scale, to balance any equities that might weigh against the injunction”).

The only question before this Court is whether the FTC has raised issues “so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by [a] Court of Appeals.” *Heinz*, 246 F.3d at 714-15 (quoting *Beatrice Foods*, 587 F.2d at 1229).

I. The FTC Will Likely Succeed on the Merits

Section 7 of the Clayton Act bars mergers or acquisitions “the effect of [which] may be substantially to lessen competition, or to tend to create a monopoly” in “any line of commerce or . . . activity affecting commerce in any section of the country.” 15 U.S.C. § 18. “Congress used the words ‘*may* be substantially to lessen competition,’ to indicate that its concern was with probabilities, not certainties.” *Heinz*, 246 F.3d at 713 (quoting *Brown Shoe*, 370 U.S. at 323). The Clayton Act thus addresses possibilities, meaning that the FTC “need not prove to a certainty that the merger will have an anticompetitive effect” but instead “need only show that there is a ‘reasonable probability’ that the challenged transaction will substantially impair competition.” *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1072 (D.D.C. 1997) (quoting *FTC v. Univ. Health Inc.*, 938 F.2d 1206, 1218 (11th Cir. 1991)).

In assessing whether the FTC raises “serious, substantial” questions, courts may follow the same approach used to evaluate the merits of a Section 7 claim. In the Section 13(b) context, courts have relied on the burden-shifting framework set forth in *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 982-83 (D.C. Cir. 1990), to guide the likelihood of success analysis. See *CCC Holdings*, 605 F. Supp. 2d at 36-37. The FTC bears the burden of demonstrating that the proposed merger would lead to “undue concentration in the market.” *Baker Hughes*, 908 F.2d at 982. By showing that a transaction will lead to undue concentration in a properly defined relevant market, the government establishes a presumption that the transaction will substantially lessen competition. *Id.* (citing *United States v. Citizens & S. Nat’l Bank*, 422 U.S. 86, 120-22 (1975); *United States v. Phila. Nat’l Bank*, 374 U.S. 321, 363 (1963)). The burden then shifts to Defendants to rebut the presumption of illegality. *Id.* This Court need not resolve the merits of Defendants’ rebuttal case, however. It need only assess whether the FTC has raised “serious,

substantial” questions. *See Whole Foods*, 548 F.3d at 1035 (Brown, J.) (“In any case, a district court must not require the FTC to prove the merits” in a Section 13(b) “preliminary injunction proceeding.”).

A. The Proposed Acquisition is Presumptively Unlawful in North American Markets

The evidence raises “serious, substantial, difficult and doubtful” questions. Graco and ITW both wield large — indeed, the largest — shares in industrial liquid finishing pumps, spray guns, and proportioners. Graco admits that [REDACTED]

[REDACTED]⁶³ As simply a matter of size, post-acquisition, Graco will dominate the industry and wield more than four times the share of its next closest (and last remaining) significant competitor, with smaller firms relegated to the competitive fringe. This alone warrants the preliminary injunction. *See, e.g., Heinz*, 246 F.3d at 725 (significant increase in concentration can pose a “substantial question” that warrants entry of a preliminary injunction).

1. Relevant Markets

Under Section 7 of the Clayton Act, courts assess a transaction’s probable competitive effects within a “line of commerce,” or relevant product market, and a “section of the country,” or relevant geographic market. 15 U.S.C. § 18; *see United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 618-23 (1974); *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 156 (D.D.C. 2000). *But see Whole Foods*, 548 F.3d at 1036 (Brown, J.) (noting “this analytical structure does not exhaust the possible ways to prove a § 7 violation”) (citing *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 660 (1964)). Market definition assists in distinguishing close

⁶³ [REDACTED]

competitive products from those that are more distant, bringing into focus the principal question: Does the acquisition significantly reduce competition between close competitors? 4 P. Areeda & H. Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶ 913a (3d ed. 2004 & Supp. 2011).

Yet market definition is not an end in itself. *See Whole Foods*, 548 F.3d at 1036 n.1. Rather, defining relevant markets helps identify and illuminate the acquisition’s potential for creating anticompetitive effects. *See* 2B P. Areeda & H. Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application*, ¶ 531a (3d ed. 2004 & Supp. 2011); *Whole Foods*, 548 F.3d at 1036-37 (Brown, J.) (“[A] district court’s assessment of the FTC’s chances will not depend, in every case, on a threshold matter of market definition.”); *see also FTC v. Indiana Fed’n of Dentists*, 476 U.S. 447, 460-61 (1986) (“Since the purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition, ‘proof of actual detrimental effects, such as a reduction of output,’ can obviate the need for an inquiry into market power, which is but a ‘surrogate for detrimental effects.’” (citing 7 P. Areeda & H. Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Applications* ¶ 1511a at 429 (1986))). As the recently revised Merger Guidelines advise, “[e]vidence of competitive effects can inform market definition, just as market definition can be informative regarding competitive effects.” Merger Guidelines § 4; *see also* U.S. Department of Justice and Federal Trade Commission, *Commentary on the Horizontal Merger Guidelines* (2006) at 10 (“Evidence pertaining more directly to a merger’s actual or likely competitive effects also may be useful in determining the relevant market in which effects are likely.”). The evidence from Defendants’ business

documents, testimony, and customers establishing that they are substantial head-to-head competitors also helps identify relevant markets. *See* Merger Guidelines § 2.1.4.

The practical realities of this industry justify the focus on anticompetitive effects in identifying adversely-affected markets. Equipment manufacturers offer a dizzying array of industrial liquid finishing pumps, spray guns, and proportioners, and related pieces and parts, in a variety of configurations. End users rely on these components in a seemingly infinite number of potential industrial applications, each of which has its own exacting equipment needs. This implies that a myriad—dozens, perhaps hundreds—of highly-specific pump, spray gun, and proportioner markets may exist. Each such market could be exceptionally small in size.

Fundamentally, however, all of the potential narrow markets share the same competitive dynamics that raise serious, substantial competitive questions about this acquisition. In dominating overall industrial liquid finishing equipment sales for resale, Graco and ITW dominate sales for pumps, spray guns, and proportioners and compete closely against each other in each category. The importance of distribution, brand reputation, and the loyalty of the installed base of end users characterizes all of these markets. In this highly differentiated product space with highly idiosyncratic demand specific to each end user, precise identification of every small affected market would be, as *Brown Shoe* warned, both “impractical” and “unwarranted,” 370 U.S. at 328, particularly when the threat of anticompetitive harm looms so large. Neither the law nor common sense compels the Court to ignore the forest for the trees. To consider only excessively narrow markets “does not aid in analyzing the effects of this merger,” *Brown Shoe*, 370 U.S. at 327, and would trivialize the significant threat to competition Graco’s acquisition of ITW poses.

Moreover, given the substantial degree to which Graco and ITW win sales from each other, Graco's and ITW's dominance in pumps, spray guns, and proportioners means they must dominate narrower markets as well. If Graco and ITW did not compete in most if not all of the narrower markets that might exist, the evidence would not show substantial competitive displacement, discounting, and head-to-head competition between the two firms that appears throughout their business documents. Graco and ITW could not compete so closely and aggressively and maintain such dominant market shares without dominating potential smaller markets as well, regardless of how finely they may be defined.

a. The Manufacture and Sale of Liquid Finishing Pumps for Industrial Use Is a Relevant Product Market

Specialized pumps move and circulate finishing liquids at a controlled pressure, flow rate, and temperature. A liquid finishing system may use multiple pumps of different designs, depending on the requirements of the painting system. Liquid finishing pumps encompass a variety of technologies, operate at different pressures and flow rates, and utilize different propulsion power (electric, hydraulic, pneumatic).⁶⁴ The required performance characteristics for a specific finishing application dictate the appropriate pump.⁶⁵ As with other industrial liquid finishing equipment, end users select pumps based on cost and performance considerations, including pump capacity, shear (material degradation), and cost of ownership.⁶⁶ Brand

64 [REDACTED]

65 [REDACTED]

66 [REDACTED]

reputation and prior experience with the brand are also major factors for end users when selecting a pump.⁶⁷

While these considerations suggest a great many small finishing pump markets (and a specific type of pump market is further alleged below), the boundaries of a pump market may be blurry and difficult to draw. A single pump model could serve a variety of end uses, just as an end use may be satisfied by a variety of different pump models and designs.⁶⁸ A value-added distributor can design or engineer systems using the same pump in a variety of ways, which can broaden and obscure the boundaries of a pump market.⁶⁹ And because industrial end users buy finishing equipment from distributors, manufacturers generally could not charge different prices for the same pump sold to different end use applications, which poses additional complications for defining markets too narrowly.

Most importantly, because each pump market would share the same inherent market characteristics, there is no need to separately identify the narrowest possible markets. In all pump markets, brand reputation, end user loyalty, and quality distribution are the hallmarks of competition. [REDACTED]

[REDACTED]⁷⁰

From a product development standpoint, Graco and ITW develop pumps with wide potential

67 [REDACTED]

68 [REDACTED]

[REDACTED]

69 [REDACTED]

70 [REDACTED]

[REDACTED]

uses that distributors can market and sell to a variety of end users.⁷¹ And they do so in competition with each other, [REDACTED]

[REDACTED]⁷² Indeed, no firm could compete for distribution successfully with just one pump, simply because most distributors would find it unprofitable to carry just a single product by a manufacturer.⁷³

b. The Manufacture and Sale of Liquid Finishing Applicators (Spray Guns) for Industrial Use Is a Relevant Product Market

Spray guns apply paint and other liquid coatings to a surface.⁷⁴ When selecting a spray gun, end users take into account factors such as the surface they are coating, the paint or material they are spraying, the desired quality and consistency of finish, the amount of wasted liquid or overspray, regulatory requirements, ergonomics, gun weight, and the preferences of the individual in the plant holding the gun.⁷⁵ Other types of equipment are not interchangeable with industrial liquid finishing spray guns.

71 [REDACTED]

72 [REDACTED]

73 [REDACTED]

74 [REDACTED]

75 [REDACTED]

While these factors may suggest a number of very small spray gun markets,⁷⁶ as with pumps, defining every affected spray gun market would be impractical and unwarranted. Such fine distinctions do not help assess the anticompetitive effects of the acquisition. Even different models of the same type of spray gun might not be substitutes, as each model may be designed for different end uses and operate at different pressures.⁷⁷ Nonetheless, regardless of their specific product attributes, all spray guns perform the same basic function and share the same competitive dynamics. Manufacturers sell most spray guns to distributors, and distributors resell those spray guns to end users familiar with the brand's reputation and performance history, along with the same value-added services they provide to end users of pumps.

c. The Manufacture and Sale of Plural Component Liquid Finishing Equipment (Proportioners) for Industrial Use Is a Relevant Product Market

Plural component equipment (sometimes referred to as proportioners) mix paint with catalysts and other liquids in precise ratios before spraying the product. Manual spray gun systems usually use manual proportioners, which are operated by an individual regulating the flow rate. Robotic or other automated systems use automatic proportioners with the flow rate regulated by a computer. Manual or automatic proportioners come in low-end, medium-end, and high-end segments, each one increasing in complexity, capability, and price. A basic low-end

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plural component unit can mix a single color,⁷⁸ while more sophisticated proportioners can handle multiple colors and catalysts and offer some flexibility in configuration and control.⁷⁹ End users choose between equipment based on the technical specifications required for their specific application, as well as brand reputation, ease of maintenance, and past experiences with the brand.⁸⁰

d. The Manufacture and Sale of Circulation Pumps for Paint Systems in Automotive Assembly Plants Is a Relevant Product Market

Circulation pumps move paint and other coating materials from tanks to various points along an assembly line, where the coating is applied to the surfaces of parts under assembly.⁸¹ In the highly-sophisticated paint systems found in automotive assembly plants, circulation pumps must meet exacting performance requirements. These pumps must operate continuously, safely, and reliably to propel the paint at a specified flow rate and pressure, and they must not jeopardize the quality and consistency of the finish by exposing the paint or coating material to excessive heat or agitation.⁸² New advances in paint and coating materials create additional challenges.⁸³ In this application, a poorly-performing pump could lead to higher costs and poor or inconsistent finish quality a particularly critical concern for automotive manufacturers, who place enormous

78 [REDACTED]

79 [REDACTED]

80 [REDACTED]

81 [REDACTED]

[REDACTED]

82 [REDACTED]

[REDACTED]

83 [REDACTED]

[REDACTED]

value in the finished appearance of their products.⁸⁴ As a result, automotive manufacturers require extensive testing before approving of a pump in this use.⁸⁵ Circulation pumps comprise the largest single equipment expense on the paint circulation system, and while system designs vary, a typical paint circulation system requires anywhere from [REDACTED] circulation pumps.⁸⁶ Consequently, although many different pump designs exist, very few pumps are suitable for this application, and an increase in the prices of these pumps would not cause automotive manufacturers to switch to other designs.

e. The Manufacture and Sale of Industrial Liquid Finishing Equipment for Resale is a Relevant Product Market

Industrial liquid finishing equipment manufacturers rely on independent distributors to sell and market their products to end users.⁸⁷ The two firms aggressively compete to win “mindshare” from these distributors.⁸⁸ To reach the most end users and ultimately sell more of their products, manufacturers compete to sell to the best, most capable liquid finishing distributors.⁸⁹ *See, e.g., FTC v. Coca-Cola Co.*, 641 F. Supp. 1128, 1135 (D.D.C. 1986) (“Given the importance of effective distribution, [soft drink] concentrate companies naturally seek to

84 [REDACTED]

85 [REDACTED]

86 [REDACTED]

87 [REDACTED]

88 [REDACTED]

89 [REDACTED]

market their products through bottlers with the greatest resources and strongest local market share.”), *vacated*, 829 F.2d 191 (D.C. Cir. 1987). Distributors benefit from the close competition between Graco and ITW on special one-time pricing, volume-based discounts, rebates, and promotional programs, all designed to keep the top distributors promoting their brands first and foremost.⁹⁰ However, these proverbial carrots dangled in front of distributors by Graco and ITW are followed by the inevitable stick.⁹¹ [REDACTED]

Post-transaction, competition for these top distributors and the benefits received by these distributors will be extinguished. By and large, Graco and ITW have tied up this limited pool of top distributors.⁹⁵ Graco no longer will need to ply its distributors with carrots to receive top billing on their line cards. Graco will have achieved domination of their distributors’ mindshare. After the acquisition, no other brand could replace Graco’s products at these

90 [REDACTED]

91 [REDACTED]

92 [REDACTED]

93 [REDACTED]

94 [REDACTED]

95 [REDACTED]

distributors only ITW has a similarly strong reputation with end users and a sufficiently broad product offering that provides distributors with a credible threat to replace Graco's products.⁹⁶ Because Graco will face less competition for sales to distributors after the acquisition, industrial end users will likely pay higher prices for industrial liquid finishing equipment.

2. North America is a Relevant Geographic Market

North America is a relevant geographic market in which to analyze the effects of Graco's proposed acquisition of ITW Finishing. Courts define relevant geographic markets by way of "the 'area of effective competition . . . in which the seller operates, and to which the purchaser can practicably turn for supplies.'" *Phila. Nat'l Bank*, 374 U.S. at 359 (quoting *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961)). A relevant geographic market is where "consumers can practically turn for alternative sources of the product and in which the antitrust defendant faces competition." *Staples*, 970 F. Supp. at 1073 (quoting *Morgenstern v. Wilson*, 29 F.3d 1291, 1296 (8th Cir. 1994)).

Because end users require sales and support from relatively local distributors,⁹⁷ distributors constitute a class of customers largely bound to identifiable geographic regions, which enables manufacturers to price and sell equipment specifically for North America.⁹⁸ See Merger Guidelines § 4.2.2. This holds true for each product market at issue, whether broad or narrow, and while equipment manufacturers worldwide may sell into North America, the

96 [REDACTED]

97 [REDACTED]

98 [REDACTED]

importance of local distribution means that sales into North America is a proper geographic dimension to evaluate these product markets.⁹⁹

3. Graco's Acquisition of ITW Would Significantly Increase Market Concentration

[REDACTED]¹⁰⁰

A merger that leads to high market concentration is presumed to have anticompetitive effects. *See Heinz*, 246 F.3d at 716; *CCC Holdings*, 605 F. Supp. 2d at 44. Such a merger is “so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.” *Phila. Nat’l Bank*, 374 U.S. at 363; *accord Heinz*, 246 F.3d at 715.

Under the antitrust agencies’ guidelines and as endorsed by case law, an acquisition is presumptively anticompetitive if it increases the HHI in a market by more than 200 points and results in a post-acquisition HHI that exceeds 2500. *See Merger Guidelines* § 5.3; *see also Heinz*, 246 F.3d at 716 (“Sufficiently large HHI figures establish the FTC’s prima facie case that a merger is anti-competitive.” (citing *Baker Hughes*, 908 F.2d at 982-83 & n.3)); *FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1503 (D.C. Cir. 1986) (noting that post-merger HHI of 3295 entitled the Commission to preliminary relief). That threshold is easily met here.

The best evidence of Graco’s and ITW’s sky-high market shares comes not from an independent source but from the parties themselves. [REDACTED]

[REDACTED]

⁹⁹ [REDACTED]

¹⁰⁰ [REDACTED]

[REDACTED]

[REDACTED]

While each estimate varies slightly, and the nature of the industry seems to resist definitive market shares, taken together they point to an overwhelming and inescapable conclusion. Graco's acquisition would significantly increase concentration in each and every relevant market. This is not a close case.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]⁰³ Based on this

estimate, the acquisition would result in a post-acquisition HHI of over 4400 and an increase in HHI of approximately 2000, far exceeding the thresholds set forth in the Merger Guidelines and supported in the case law.

101 [REDACTED]

102 [REDACTED]

[REDACTED]

103 [REDACTED]

[REDACTED]

In proportioners, for example, [REDACTED]

[REDACTED]¹¹⁰ which would give Graco [REDACTED] post-merger. [REDACTED]

[REDACTED]¹¹¹

Thus the story is clear, regardless of how finely these categories are further divided. The acquisition substantially increases market concentration and gives Graco control over the majority of industrial liquid finishing sales. [REDACTED] confirm this view of industry concentration. Their North American industrial liquid finishing sales are far smaller

¹⁰⁹ [REDACTED]

¹¹⁰ [REDACTED]

¹¹¹ [REDACTED]

¹¹² [REDACTED]

¹¹³ [REDACTED]

than Graco's and ITW's and are consistent with the small shares [REDACTED]

[REDACTED] 114

These alarmingly high market shares could actually *understate* the competitive harm Graco's acquisition poses. The importance of distributor access, the significance of brand value and reputation, and a risk-adverse installed base of end users reluctant to change equipment brands all would magnify the acquisition's likely competitive harm. Nevertheless, however one measures markets and share, the proposed acquisition presumptively violates the Clayton Act and the FTC Act. *See Elders Grain*, 868 F.2d at 902 (affirming preliminary injunction requiring rescission of acquisition that increased market share of largest firm from 23% to 32%); *Hosp. Corp. of Am.*, 807 F.2d at 1384 (affirming Commission's decision that Section 7 of Clayton Act was violated by acquisitions that increased acquiring entity's market share from 14% to 26%); *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 52-53 (D.D.C. 1998) (preliminarily enjoining mergers increasing HHIs from 1648 to 2450 and from 1648 to 2277, increasing market shares from 22% to 40% and from 25% to 37%).

B. A Competitive Effects Analysis Raises More "Serious, Substantial" Questions

The FTC's prima facie case creates a strong presumption of illegality and a high burden for Defendants to explain why "the market-share statistics [give] an inaccurate account of the [merger's] probable effects on competition' in the relevant market[s]." *Heinz*, 246 F.3d at 715 (quoting *Citizens & S. Nat'l Bank*, 422 U.S. at 120). Defendants bear a heavy burden to overcome the evidence of anticompetitive effects described above, particularly given the strength

114 [REDACTED]

of the prima facie case. *See, e.g., Baker Hughes*, 908 F.2d at 991 (“The more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully.”); *see also Heinz*, 246 F.3d. at 725; *Swedish Match*, 131 F. Supp. 2d at 167. Defendants cannot overcome this presumption.

The issues here extend far beyond market shares, as extraordinary as they may be. Through this acquisition, Graco will eliminate its close competitor and free itself from the competitive constraints ITW now imposes. [REDACTED]

[REDACTED] Formidable barriers prevent new firms from mitigating the injury to customers, [REDACTED] and as shown by the absence of competitively meaningful entry over time. *See, e.g., Heinz*, 246 F.3d at 725 (barriers to entry can pose a “substantial question” that warrants entry of a preliminary injunction). A competitive response from other firms—either by the growth or repositioning of existing competitors, or by the entry of new ones—would not sufficiently curb the anticompetitive harm even if Graco in effect invited entry by raising prices post-acquisition.

1. The Proposed Acquisition Would Likely Result in Significant Anticompetitive Effects in the Relevant Industrial Liquid Finishing Equipment Markets

Under the Merger Guidelines, fears of post-merger unilateral price effects increase as more “buyers of products sold by one merging firm consider products sold by the other merging firm to be their next choice.” Merger Guidelines § 6.1; *see also CCC Holdings*, 605 F. Supp. 2d at 68. A close competitor need not be the closest competitor in all market segments to support concerns of unilateral effects. *See* 4 P. Areeda & H. Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application*, ¶ 914a (3d ed. 2004 & Supp. 2011) (merging parties

need not be the closest rivals for unilateral anticompetitive effects to arise); *United States v. H&R Block, Inc.*, No. 11-00948, 2011 U.S. Dist. LEXIS 130219, at *126 (D.D.C. Nov. 10, 2011) (“A merger may produce significant unilateral effects even though a non-merging product is the ‘closest’ substitute for every merging product. . . .” (quoting Commentary on the Horizontal Merger Guidelines at 28)).

Graco and ITW recognize that they match closely, not just in their dominance of the distribution channel, but also across the spectrum of industrial liquid finishing guns, pumps, and proportioners. Although the firms are not identical twins and their strengths vary somewhat by category, [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

As discussed above, Graco and ITW compete closely and fiercely in each product market. They compete on price, by offering discounts and rebates to distributors who sell their products and by granting one-time pricing relief when competing head-to-head, and they compete on product development and innovation. [REDACTED]

[REDACTED]

115 [REDACTED]

116 [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] *See Swedish Match*, 131 F. Supp. at 169 (“High margins and high diversion ratios support large price increases, a tenet endorsed by most economists.”).

2. The Proposed Acquisition Would Result in a Merger-to-Monopoly for Circulation Pumps for Paint Circulation Systems in Automotive Assembly Plants

In the sale of circulation pumps used in automotive assembly plants’ paint systems, Graco and ITW are the only competitively-significant players today. [REDACTED]

[REDACTED]¹¹⁸ Graco’s acquisition would extinguish current vigorous competition on price and product innovation. No new pump could enter rapidly enough to mitigate this harm.

Graco and ITW manufacture the only paint circulation pumps currently suitable for use in the highly sophisticated paint systems used by the automotive assembly industry. Other types of pumps do not perform as well in this use, and although small numbers of other brands may currently be found in some automotive plants, automotive customers would not specify or

[REDACTED]

117 [REDACTED]

118 [REDACTED]

approve these pumps for use today.¹¹⁹ Graco and ITW compete head-to-head by offering sizable discounts against each other,¹²⁰ and by improving their product design.¹²¹ Because a bad pump can be so costly, automotive manufacturers insist on extensive product testing in real-world operating conditions before approving a pump for use, and only over extended time could a new pump gain sufficient reputation to become a competitively significant option in this use.¹²²

This is not a trivial concern. Graco recognizes the long-term strategic significance of selling a pump especially to major end users such as automotive manufacturers, where a single pump can generate sales of spare parts, replacement pumps, and other equipment. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]¹²³ Moreover, sales in this segment translate into product development and sales in adjacent product categories, [REDACTED]

[REDACTED]¹²⁴ This rivalry, which

119 [REDACTED]

120 [REDACTED]

121 [REDACTED]

122 [REDACTED]

123 [REDACTED]

124 [REDACTED]

has led to lower prices and better products for customers,¹²⁵ will be forever extinguished post-merger.

3. Repositioning and Entry Are Unlikely to Constrain Anticompetitive Effects

Competition lost by the acquisition will not be mitigated by expanding sales or repositioning of Exel or other firms on the competitive fringe. Nor will competitively-significant entry likely occur. The importance of brand reputation, high installed base switching costs, and constraints on quality distribution strongly support [REDACTED] that even reliable products could offer only limited competition in these markets over a short timeframe.¹²⁶ Nothing in this transaction appears to change that dynamic.

Without access to quality distribution [REDACTED] Exel or other competitors could not deter post-merger anticompetitive effects in these markets. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

¹²⁵ [REDACTED]

¹²⁶ [REDACTED]

¹²⁷ [REDACTED]

[REDACTED]²⁸ The history of competition in this industry bears this out as well. [REDACTED]

[REDACTED]

[REDACTED]¹³⁰ Other firms on the competitive fringe stand even less chance of securing competitively-significant distribution after the acquisition.

Nor can Defendants show that new entry in these markets would be “timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the competitive effects of concern.” Merger Guidelines § 9; *see also Cardinal Health*, 12 F. Supp. 2d at 54-58; *Staples*, 970 F. Supp. at 1086. [REDACTED]

[REDACTED]

[REDACTED]¹³¹ *See Cardinal Health*, 12 F. Supp. 2d at 56 (“The history of entry into the relevant market is a central factor in assessing the likelihood of entry in the future.”); *see also* Merger Guidelines § 9.

[REDACTED]

[REDACTED]

128 [REDACTED]

[REDACTED]

129 [REDACTED]

130 [REDACTED]

[REDACTED]

131 [REDACTED]

[REDACTED]

4. Efficiencies Cannot Save the Acquisition

A good deal for Graco is plainly a bad deal for Graco’s customers and for North American industrial end users. The acquisition will not produce significant cost savings to benefit consumers and offset the acquisition’s anticompetitive effects. To carry weight in merger analysis, claims of efficiencies must be cognizable, meaning that they must be merger-specific, verifiable, and not arising from anticompetitive reductions of output or service. *Heinz*, 246 F.3d at 721-22; *see also* Merger Guidelines § 10. Any efficiencies related to this acquisition clearly fall short of this test. Moreover, Graco plans to operate ITW as a separate business post-acquisition, thereby postponing achievement of any operational efficiencies.¹³⁴ [REDACTED]

[REDACTED]

132 [REDACTED]

133 [REDACTED]

134 [REDACTED]

135 [REDACTED]

II. The Equities Heavily Favor a Preliminary Injunction

Serious and substantial antitrust concerns “militate for a preliminary injunction unless particularly strong equities favor the merging parties.” *Whole Foods*, 548 F.3d at 1035 (Brown, J.); *see also Heinz*, 246 F.3d at 727. Section 13(b) embodies Congressional recognition that divesting assets after an acquisition has been consummated is an inadequate and unsatisfactory remedy, H.R. Rep. No. 94-1373 (1976), as reprinted in 1976 U.S.C.C.A.N. 2637, 2640-41, a point that has been emphasized by the United States Supreme Court, *see, e.g., FTC v. Dean Foods Co.*, 384 U.S. 597, 607 (1966) (“Administrative experience shows that the Commission’s inability to unscramble merged assets frequently prevents entry of an effective order of divestiture.”), and other cases. *See also Heinz*, 246 F.3d at 726; *FTC v. ProMedica Health System, Inc.*, No. 3:11 CV 47, 2011 WL 1219281, at *60 (N.D. Ohio 2011). Moreover, divestiture after a full hearing on the merits cannot remedy the harm suffered by customers and consumers in the interim. *See, e.g., Elders Grain*, 868 F.2d at 904. These considerations explain why, once the FTC establishes the likelihood of prevailing in a full hearing on the merits, “it will usually be able to obtain a preliminary injunction.” *CCC Holdings*, 605 F. Supp. 2d at 75.

A preliminary injunction to preserve the status quo will prevent interim harm during the administrative proceeding on the merits and will preserve the potential for effective relief should the FTC ultimately prevail. No equities favor Defendants. There is no reason why the merger, if found lawful, could not occur after the close of the administrative proceeding before the FTC. *See Heinz*, 246 F.3d at 726-27.

CONCLUSION

The FTC has raised serious, substantial, difficult, and doubtful questions about the injury to competition posed by Graco’s acquisition of ITW, which would combine the two dominant

close competitors in markets characterized by high entry barriers, high switching costs, and limited access to a critical distribution channel. Because the Commission should investigate and adjudicate these serious questions in the first instance, and because injunctive relief is necessary to preserve the benefits of competition and the Commission's ability to craft a remedy, the FTC respectfully asks the Court to grant a temporary restraining order and preliminary injunction delaying consummation of the acquisition pending administrative adjudication of its antitrust merits.

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